

Cooley Godward LLP

ATTORNEYS AT LAW

Five Palo Alto Square
3000 El Camino Real
Palo Alto, CA
94306-2155
Main 650 843-5000
Fax 650 849-7400

Broomfield, CO
720 566-4000
Reston, VA
703 456-8000
San Diego, CA
858 550-6000
San Francisco, CA
415 693-2000

www.cooley.com

FREDERICK D. BARON
(650) 843-5020
fbaron@cooley.com

November 25, 2003

VIA FACSIMILE AND MESSENGER

Mr. Darryl Woo
Fenwick & West LLP
801 California Street
Mountain View, CA 94041

**CONFIDENTIAL/INADMISSIBLE –
SETTLEMENT PURPOSES ONLY**

Re: XHP Microsystems – Dr. Shaoher Pan

Dear Darryl:

On behalf of our client, Dr. Shaoher Pan, I am writing in response to your letter of November 14, 2003, regarding the proprietary information of XHP Microsystems, Inc. ("XHP") and other matters related to the employment separation of Dr. Pan. This response is for settlement purposes only and it is inadmissible in any legal proceeding.

1. Proprietary Information and Inventions Issues.

First, your letter sought to remind Dr. Pan of his obligations under his Employee Invention Assignment and Confidentiality Agreement (the "Confidentiality Agreement") and to ensure his compliance with that agreement. There is no problem in this regard. Dr. Pan is committed to abide by all of his lawful obligations under the Confidentiality Agreement, and he is in full compliance with them.

For example, to the best of Dr. Pan's knowledge, he is not in possession of any XHP property, documents, or materials, or any embodiments of XHP's proprietary information. His company laptop computer was returned in late August, 2003. Following his employment at XHP, Dr. Pan received from Fenwick & West, three draft continuation patent applications. He has separately responded to Michelle Lee at Fenwick & West with regard to those applications, and he is returning herewith his only copies of them. It is worth noting that when Dr. Pan was summarily escorted from XHP without warning on August 19, 2003 (prior to his formal termination on August 22, 2003), he was not afforded the opportunity to retrieve his personal property, which is still in the possession of XHP.

Dr. Pan has, in fact, disclosed to XHP all inventions that he made, conceived, or first reduced to practice during his employment at XHP. He will continue to assist XHP in every proper way to obtain and protect its intellectual property rights as provided in Section 6 of the Confidentiality Agreement. Dr. Pan will also refrain from using or disclosing the proprietary information of XHP as required by Sections 7 and 8 of the Confidentiality Agreement.

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Your letter alleged that Dr. Pan possessed certain "undocumented inventions" belonging to XHP. This allegation is untrue. Dr. Pan does not possess any such inventions, nor did he inform anyone that he did. In his first meeting with Mark Stevens and Ajit Shah to discuss possible future roles for him at XHP after his termination, Dr. Pan was asked to submit any undocumented XHP inventions. This meeting took place after the August board meeting. Dr. Pan did not submit any undocumented inventions because no such inventions existed.

After the termination of his employment (the last active day of which was August 19, 2003, when he was placed on "administrative leave," and the formal termination of which was on August 22, 2003), Dr. Pan sent an e-mail (attached as an appendix hereto) on August 27, 2003, to both Mark Stevens and Ajit Shah as a follow-up to discussions he had with them about transitioning to a new role at the Company. In the email, Dr. Pan listed a set of well-known problems in the micro-electro mechanical systems ("MEMS") industry that would be interesting areas to explore for future technical development. Each item on the list represented a broad scientific and engineering problem area well known as a current challenge in the MEMS industry. However, the email did not indicate that Dr. Pan had made technical developments in those areas while he was employed at XHP. Rather, Dr. Pan was clearly communicating his interest in working on those challenges from that point forward, either independently or as an employee of XHP, if a reinstatement could be negotiated.

In two separate conversations, one in the beginning of September, and the other in the first week of October, Worldview associate Steve Eglash told Dr. Pan that Ajit Shah was expecting information on "undocumented inventions" by Dr. Pan. On both occasions, Dr. Pan asked Eglash to explain that Dr. Pan had not developed any undocumented inventions prior to his departure from XHP, but if XHP were to allow Dr. Pan to continue working for XHP, he would attempt to invent technology in the areas that he had outlined in the email. Both times Eglash promised to convey the message. In October, Eglash also told Dr. Pan that the XHP investor board members were considering making an offer to Dr. Pan to return to XHP. In the October conversation, Dr. Pan informed Eglash that, following his termination, he had used his free time to develop new inventions, utilizing his general know-how and expertise, and not making any use of XHP proprietary information. Dr. Pan expressed his hope that the XHP investors would allow him to return to XHP as an employee so that XHP could benefit from his independent efforts at innovation.

At present, however, Dr. Pan has not been re-employed by XHP. He does not possess any XHP inventions that were not previously disclosed to XHP. And, XHP cannot lawfully act to interfere with Dr. Pan's prospective economic advantage by asserting unfounded claims to any inventions he may develop following his employment at XHP. Dr. Pan will comply with his inventions obligations under the Confidentiality Agreement, but XHP cannot prevent him from pursuing a livelihood by means of his well established expertise and inventive capabilities in his field, in which he has extensive original publications and patents, independent of his work at XHP.

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2. Expense Reimbursement and Other Financial Issues.

Your letter raises several questions regarding expenses incurred by Dr. Pan and other financial matters related to XHP. Set forth below are Dr. Pan's responses on all of these matters.

(a) **Citibank Funds.** Your letter indicates that Dr. Pan attempted a transfer of \$3 million from XHP's Citibank account on August 22. Dr. Pan acknowledges that he inquired as to the possibility of such a transfer, but he did not believe it improper. He simply inquired with Citibank about whether he could make the transfer to XHP's Silicon Valley Bank account on August 20, while he was still employed at XHP and still the Treasurer of the company as far as he knew. Dr. Pan did not believe that the board had acted lawfully in notifying him that it planned to terminate his employment at XHP. He considered the transfer of funds to another XHP account because he believed he had a duty to protect XHP assets while he consulted attorneys about the board's actions. In fact, no funds were transferred and Dr. Pan still has serious questions about the lawfulness of the purported board actions at the August, 2003 board of directors meeting, because a duly elected board member, James Wei, was not present, and one of his venture capital partners, Ajit Shah, acted on his behalf. Dr. Pan did not believe that Mr. Shah had the authority to do so, and still does not believe that the termination was lawful.

(b) **Expense Withdrawals.** Dr. Pan made two withdrawals, each in the amount of \$1,000, from XHP accounts on August 19, 2003. These withdrawals were for payment of his unreimbursed cash expenditures and credit card charges for XHP business expenses in July and August, prior to his termination, and for a pre-scheduled business trip the following week to TSMC in Taiwan. (Again, at that time, Dr. Pan believed that his termination was improper and that he had a duty to continue to act on behalf of XHP.) Also on August 19, Dr. Pan informed the Company's controller about the withdrawal of these advances and he was told to submit receipts after obtaining access to his office. As of this date, Dr. Pan has not been allowed access to his office and all of his expense receipts are in his office. To avoid any unnecessary dispute, Dr. Pan is reimbursing the \$2,000 amount by a personal check enclosed herewith. Nonetheless, Dr. Pan is entitled to receive reimbursement for the July and August charges upon the Company's review of his expense receipts, which should be done promptly.

(c) **Office Lease.** After the closing of the Series A funding for XHP, Dr. Pan started looking for a permanent office for XHP. Realizing that it would take several months to find and prepare a permanent new office, Dr. Pan signed a rental agreement for temporary office space at 1135 Kelez Drive in San Jose, with the property manager, his mother Shuying Li. XHP was already using the office space at that same address, which was being contributed on an in-kind basis due to the family relationship. That contribution was never reimbursed after the Series A financing. Since the Company needed a flexible lease without an early termination penalty, it would have been difficult for Dr. Pan to find an office in a convenient location in Silicon Valley that would meet XHP's needs. As an active California real estate broker, Dr. Pan believed that a monthly rent of \$6,000 was reasonable and that, because of his relationship with Shuying Li, he was, in fact, receiving more favorable terms than were generally commercially available. When Dr. Pan was recruiting Dr. Dongmin Chen to become the Company's full time VP of Engineering, XHP promised that the Company would pay Dr. Chen's first month of rent when he relocated from Boston after the Series A closing. Dr. Chen was able to live in the same space that Dr. Pan had leased as temporary offices. Dr. Pan explained the temporary lease situation at

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the first board meeting after entering the temporary lease, and he did not receive any objections. The board approved the monthly rental expenses at subsequent board meetings. All of the rental checks questioned in your letter were paid in the ordinary course of this leasing agreement.

(d) **Cash Advances.** The three "cash advance" payments referenced in your letter, totaling \$20,000, were for reimbursement of Dr. Pan's out of pocket expenditures for XHP business purposes. During the Company's early period, when the financial credit of XHP was not established, XHP relied heavily on the personal credit and expenditures of senior managers to do Company business expeditiously. XHP's practice was to reimburse managers by means of cash advances so that they could maintain their personal credit. The three checks totaling \$20,000 were for reimbursement of out-of-pocket expenditures by Dr. Pan for which he timely submitted receipts to the Company controller. At every board meeting over which Dr. Pan presided until his termination in August 2003, the board unanimously approved every spending report. Moreover, Dr. Pan was commended for managing the company's cash position.

3. Demands for XHP

(a) **Termination Authority.** Dr. Pan demands evidence and legal authority from XHP that Ajit Shah had authority to vote to terminate Dr. Pan at the August board meeting when he was not a duly elected board member. In the absence of such authority, Dr. Pan should be reinstated as CEO.

(b) **Technology Transfer.** In the Assignment of Technology Agreement that Dr. Pan executed with the Company as of November, 2002, Dr. Pan transferred his interest in the Technology (as defined therein) in exchange for the Company's issuance of 5.5 million shares. In Dr. Pan's view, a majority of those shares have now been purportedly repurchased by the Company due to his improper termination. Thus it is his position that he has been deprived of the consideration for the technology transfer, which is now invalid. Dr. Pan seeks reinstatement to his position at the Company, which will permit his continued vesting and remedy this problem.

(c) **Reimbursement of Expenditures.** Dr. Pan and his family spent hundreds of thousands of dollars of personal capital and in-kind contributions in building XHP before the Series A closing. Dr. Pan requested reimbursement of these expenditures and as of this date, he has not received such reimbursement. He requests a commitment by the Company to make this reimbursement (as well as reimbursement for subsequent unreimbursed business expenses) and to allow him access to his records that are at the Company so that he can prepare a specific submission for reimbursement.

(d) **Inspection and Production of Employment Records.** Dr. Pan requests prompt production by the Company of a copy of all agreements he has signed with the Company, and a prompt arrangement to inspect all personnel records pertaining to him at the Company, as permitted by statute.

(e) **Assurance Regarding Duties to Shareholders.** Dr. Pan request an assurance from the XHP board that it will adhere to its ongoing fiduciary duty to act in the best interests of all shareholders, including Dr. Pan who is the largest common stock shareholder of XHP.

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* * *

This letter has addressed all of the issues raised in your November 14, 2003 letter. If you have additional questions, please do not hesitate to contact me. While Dr. Pan has made several demands upon XHP in this letter, he reserves the right to assert other claims and demands as we analyze the past events at XHP.

Dr. Pan remains willing to consider consulting with XHP on some basis other than reinstatement, in order to help XHP develop its technology, but only if this can be done as part of a mutually acceptable separation and release agreement.

Sincerely,

Cooley Godward LLP



Frederick D. Baron

Enclosures

cc: Shaoher Pan

APPENDIX

E-mail from Shaoher Pan on August 27, 2003.

Dear Mark and Ajit,

Let me first thank you and Steve for taking the time to meet with me. I accept that it is time for me to transition to another role in the company. I am extremely concerned about the future of XHP and, despite all that has happened, wish to continue to contribute to its success.

We can discuss the specifics of what role makes sense. I propose that I become an individual contributor, such as Chief Technology Officer, for the reasons and with the specific duties and expectations discussed below.

I would also propose that I commit to certain concrete actions to demonstrate my commitment to XHP's success. As a start, I suggest that we have a meeting with all employees. With the full board present, I would explain to the employees why it is time to bring in a new management team, and ask for everyone's cooperation to support the new management team for a smooth transition. I believe that this meeting is necessary to reassure the number of executives and employees who are currently alarmed about the company's future. I believe smooth transitions are best for morale and stability (internally as well as in the market).

The other actions are the following:

1. Build the XHP patent portfolio

I know that I will continue to develop many innovative ideas, whether at XHP or elsewhere. If still part of XHP, I can continue this development work for the company's benefit, whether at home or on the company's premises. I believe that one of the greatest long-term assets of XHP is its burgeoning intellectual property assets. Followings are some of the patents I like to spend sometime to work on immediately:

- Unique dual layer etching process for micro-display;
- Integrated micro-display manufacturing process without micron level alignment;
- Two steps processes for fabricating hidden hinge micro-display;
- Precision mechanical stop for micro-display;
- Plasma induced stiction reduction for silicon-silicon and silicon-nitride interfaces;
- Wafer-level-chip-scale packaging for hidden hinge micro-display.

2. Travel to vendors and customers

I would like to travel when requested to vendors' and customers' sites to promote XHP technology, resolve the engineering issues, and listen to customer feedback. I believe that my presence as the CTO would add a measure of comfort from a technology standpoint.

3. Help market XHP to the industry

I believe that I can help establish market credibility for XHP among the industry leaders. In addition to the experience described below, which involved working with every major foundry, I was elected and continue to hold the position of Secretary of the Bay Area Society of Information Display (SID), the largest professional organization in our field.

4. Assist the company in its technology challenges

I want to spend some time on this item, as it is the most critical for the company's future. XHP is still in a very early stage of product development. Micro-mirror displays are extremely complex opto micromechanical devices that require integrated efforts from many disciplines, especially in the unproven areas of micro-mirror array fabrication, stiction reduction, and packaging.

To fabricate the micro-display, one first needs to do plasma etching, then plasma activated bonding, and finally plasma etching again to release the mirror. As the first micro-display is fabricated, it will certainly encounter stiction problems. Many solutions exist, including using plasma induced stiction reduction method to improve the yields. XHP's micro-mirror will also require a special type of wafer-level chip-scale packaging that requires further development.

We only started to develop preliminary high-level plans and solutions to address these high-risk areas. Our job is not yet done and I would be remiss in my duties as a board member if I did not alert you to the difficulties the company faces in these areas. To address these areas and effectively work with an established foundry, we must maintain our core technical expertise. Otherwise, we risk losing much of our intellectual property rights and company value through disadvantageous joint development agreements with larger foundries.

I am uniquely qualified to help XHP resolve these problems. I was trained as a plasma physicist during my Ph.D. education. After working at the University of Pennsylvania and IBM Research, I focused on plasma applications. For example, I worked on plasma treatment for stiction reduction with Professor David Boggy and built the first Micro-stiction Lab for MEMS and Hard disk application at U.C. Berkeley - a lab that is still in use today to study mechanical stiction and to publish papers.

After I began to focus on plasma applications in semiconductor manufacturing, I led the engineering teams that built the current standard DPS etch tools installed in TSMC Fab 7. I have published more than 50 papers in the international journals, and have almost 20 patents granted on technologies related to the above. I have given seminars in almost every large foundry on semiconductor process developments.

My point in these last few paragraphs is to remind us that XHP is still a young startup that faces significant technology risks. I believe in XHP and its technology, which is why I committed all my efforts to this project. I still have more to contribute and, absent the technical guidance I can offer, I fear that XHP may not realize its potential.

I assume that the primary fear you have is whether we can continue to work together after what happened last week. It is certainly true that have much trust to regain. However, I will commit myself to assisting the rest of the board, the new management team, and the company in its continued success. I

have tangible, concrete skills to offer, and believe that XHP would gain dramatically by my continued efforts.

To continue my contributions to XHP, as described above, I request that the board reinstate my employment, with a change of title from CEO to an individual contributor, such as CTO, so that my employment with the company is uninterrupted. I know that we discussed today my taking a number of weeks away from the company. If necessary, I am willing to do this as paid leave.

I hope the board realizes my value and lets me have an opportunity to contribute to the success of XHP.

I look forward to hearing from you.

Shaohar Pan

Home: (408) 927-6185

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389
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Five Palo Alto Square
3000 El Camino Real
Palo Alto, CA
94306-2155

Offices:
Broomfield, CO
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Reston, VA
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San Francisco, CA

MAIN (650) 843-5000
FAX (650) 849-7400

DATE: November 25, 2003

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